STATE OF CALIFORNIA
BOARD OF EQUALIZATION
APPEALS UNIT

330.2523
2/16/90

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law

DECISION AND RECOMMENDATION
No. SR ----

The above-referenced matter came on regularly for hearing before Hearing Officer H. L. Cohen on November 15, 1989, in Van Nuys, California.

Appearing for Petitioner:

Appearing for the Department of Business Taxes:

Protested Items

The protested tax liability for the period April 1, 1982 through June 30, 1986 is measured by:

Item	State, Local and County	Assessment District
C. Unreported rental receipts	$159,291	$90,659
E. Late charges and property tax payments on leased property	59,608	51,946
Totals	$218,899	$142,605

Contentions

Petitioner contends that the amount subject to tax should not include late charges and property tax payments.

Summary

Petitioner is a corporation which is in the business· of leasing tangible personal property. It began in business in February 1969. The last prior audit was for the period through March 31, 1982.

Petitioner's policy is to pay sales tax reimbursement or use tax on all property purchased for lease. There were a few leases, however, upon which this was not done, and tax on these leases was paid on lease receipts. The auditor's examination of petitioner's records revealed that on some leases of property upon which no tax or tax reimbursement had been paid with respect to the purchase price, petitioner had failed to pay tax on lease receipts (Audit Item C). Petitioner initially objected to the application of tax to one lease in this category. That lease was to ---. The lease was signed February 11, 1983. It was shortly thereafter assigned to ---. The lease provided that the lessee would pay tax with respect to lease payments. Petitioner was of the opinion that -- paid tax on cost; therefore, tax was not due on lease payments. The auditor stated that the option to pay tax on cost was not timely made; therefore, tax was due on lease receipts, including those lease receipts paid to petitioner prior to the assignment of the lease. At the hearing, petitioner conceded that the auditor was correct and withdrew the objection to Audit Item C.

Petitioner entered into purchase options with respect to a number of its leases. In all cases, the option price was substantial; thus, the leases were not subject to recharacterization as conditional sales contracts. When the options were exercised, petitioner reported tax based on the option price. The leases required the lessees to pay or to reimburse petitioner for property tax on the leased property. The leases also provided for the imposition of charges for late payment of the rental amount by the lessee. Delinquencies in rental payments were, by terms of the options, regarded as abandonment of the options.

If a lessee who held a purchase option was chronically delinquent on payments to petitioner, petitioner would accrue the delinquencies. If the delinquent lessee sought to exercise the option at the end of the lease period, petitioner would require the lessee to pay all delinquent amounts at that time. The auditor regarded the payment of the delinquent amounts as part of the consideration for the transfer of title of the property. The auditor applied tax to these amounts (Audit Item E). The auditor relied on Business Taxes Law Guide (BTLG) Annotation 330.3500 (December 15, 1965) in arriving at this conclusion.

Petitioner contends that these amounts are not subject to tax. They constitute amounts due under leases which are not subject to tax. If the amounts were collected during the course of the lease when due, or at any time prior to the end of the lease period, they would not be subject to tax. It should not make any difference if they are paid at the end of the lease at the time that the purchase option is exercised.

During the hearing, petitioner discussed Audit Item H, a reporting error, but conceded that it was properly included in the amount subject to tax.

Analysis and Conclusions

Sections 6006 and 6010 of the Revenue and Taxation Code exclude from the definitions of "sale" and "purchase" the lease of property as to which sales tax reimbursement or use tax has been paid if the property is leased in the form in which it was purchased by the lessor. The sale of such property by the lessor to the lessee at the conclusion of the lease is a separate transaction that is subject to sales tax, based on the gross receipts from this latter transaction. The question here is what is the amount subject to tax.

BTLG Annotation 330.2480 (August 5, 1965) states that tax is due upon the exercise of an option to buy by the lessee, and the tax due is based on the selling price, i.e., the amount paid

by the lessee upon the exercise of the option to purchase. Petitioner has reported and paid tax on the price listed in the option agreement. The late charges relate to the lease. The property tax reimbursement is part of the consideration for the lease. See BTLG Annotation 330.3535 (February 24, 1969). The late charges and property tax reimbursement are due and owing apart from the exercise of the option. These charges are not part of the consideration paid by the lessee to obtain title to the previously leased property. The annotation cited by the auditor is ambiguous. I would read it to mean that the additional charges which it states are part of the consideration paid for the passage of title are charges specified in the option, rather than in the lease. Accordingly, I conclude that these charges are not subject to tax here.

Recommendation

Delete Audit Item E from the amount subject to tax.

_____ 2/16/90

H. L. Cohen, Hearing Officer Date